



September 10, 2010

VIA ELECTRONIC
AND OVERNIGHT MAIL

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
1155 21st Street NW
Washington, DC 20581

**Re: Application of Core Principle 9 for Designated Contract Markets to the CME/NYMEX
Clearport model**

The Wholesale Markets Brokers' Association Americas¹ ("WMBAA") appreciates the opportunity to state our position on the Commodity Futures Trading Commission Staff's ("the Staff") interpretation of DCM Core Principle 9 as it applies to CME Group's ClearPort clearing service ("CPC"). It is important to note at the outset that the WMBAA has participated only in the periphery of this discussion and has not been a party to the conversations between the Staff and the CME Group on this topic. Nevertheless, we grasp the underlying facts and recognize that this discussion has the potential to disrupt vital financial market activity and we hope that our views will aid in minimizing any unintended consequences that may result to our clients, the financial markets and the economy.

As we understand this issue, CME/NYMEX has for the past eight years operated CPC as a service of the CME/NYMEX DCM pursuant to Section 5 of the Commodity Exchange Act ("CEA")². As such, CPC is required to comply with the DCM core principles. As amended by the Wall Street Transparency and Accountability Act (the "Reform Bill"), Core Principle 9 for Designated Contract Markets ("DCM") states, in part that, "The board of trade shall provide a competitive, open and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade."³ With respect to Core Principle 9, our understanding is that the Staff expressed its concerns to the CME regarding the methodology employed by CPC. Typically,

¹ The Wholesale Markets Brokers' Association Americas (WMBAA) is an independent industry body representing the largest inter-dealer brokers (IDBs) operating in the North American wholesale markets across a broad range of financial products. The WMBAA and its member firms have developed a set of *Principles for Enhancing the Safety and Soundness of the Wholesale, Over-The-Counter Markets*. Using these Principles as a guide, the Association seeks to work with Congress, regulators, and key public policymakers on future regulation and oversight of over-the-counter (OTC) markets and their participants. By working with regulators to make OTC markets more efficient, robust and transparent, the Association sees a major opportunity to assist in the monitoring and consequent reduction of systemic risk in the country's capital markets.

² See, 7 USC §7(d)(1)(9) (2010).

³ See, H.R. 1473, 111th Cong. §735 (2010).

trades submitted to CPC are generally legally enforceable bilateral commodity swaps (or other similar swap transactions) documented under standard industry master netting agreements. The economic terms of these transactions are negotiated by the parties directly or via Interdealer Brokers (IDBs), including members of the WMBA, who are responsible for generating the vast majority of various CPC cleared contracts submitted to CME/NYMEX. After a swap transaction is entered into, it is confirmed through the exchange – often electronically - with legally binding confirmations. Assuming the parties have agreed to centrally clear the trade, the terms of the trade are then submitted to CPC for processing. At this stage, the bilateral legal obligations of each party are contractually novated, with CME Clearing becoming the legally obligated counterparty on both sides of the swap transaction. Next, CPC and CME Clearing exchange the swap for economically equivalent futures contracts that are listed on the CME pursuant to the rules of the DCM. While we do not feel that a third-party can satisfy Core Principle 9 on behalf of a DCM, nor do we imply that it would be proper for such an arrangement, we do feel that the Commission can achieve comfort in not subjecting OTC trades submitted by IDBs to this requirement for the reasons set forth below.

As an initial starting point, we observe that the Reform Bill amended Core Principle 9 to apply the requirements for a competitive, open and efficient market **solely** to “trading in the centralized market of the board of trade.” Core Principle 9, therefore, can and should be construed by the Commission as applying only to transactions that are, in fact, traded on a DCM and not to transactions, such as exchanges of futures for swaps that are submitted in compliance with DCM rules that have been adopted in compliance with Core Principle 9(B) and Commission Regulation 1.38.⁴ We believe that this view is supported by recent Commission interpretations in the context of Exchange of Futures for Futures (“EFF”), which affirmatively recognize that Core Principle 9 permits the execution of transactions outside the centralized market insofar as,

Section 4(a) of the CEA requires that all futures and options transactions take place on the centralized marketplace. [...] The importance of promoting an “open and competitive” means of price discovery was expressly endorsed by Congress with the addition of Core Principle 9 to the CEA. In so doing, Congress also granted DCMs reasonable discretion as to how to implement such policy in their markets. [...] The Commission also affirms, however, that a DCM may permit EFFs under a rule submitted to the Commission in accordance with Regulation 1.38.⁵

To those that, nevertheless, would argue that Core Principle 9 must be applied to transactions that are effected outside the “centralized market of the board of trade,” we believe that further analysis should focus on three threshold points: First, the Commission should consider the IDB execution model and the fact that transactions submitted to CPC by IDBs have been executed in a competitive, open and efficient

⁴ Of significant note is the fact that Congress intentionally elected not to make swap transactions executed on swap execution facilities (“SEFs”) subject to a requirement similar to DCM Core Principle 9.

⁵ See, Letter from David Stawick, Secretary of the Commission, Commodity Futures Trading Commission, to Kathleen M. Cronin, Esq., General Counsel, CME Group Inc. (August 13, 2010) at 5.

market that does not impact the price discovery process in the centralized board of trade. Second, compliance with Core Principle 9 does not require that all trades submitted to a DCM be executed on the DCM's proprietary electronic trading network or on a single, physical central open outcry facility. Lastly, Core Principle 9 should not be applied in the same way to futures, which may be traded by retail investors, as it may be applied to OTC products that are only eligible to be traded by professionals that qualify as Eligible Contract Participants pursuant to Section 2(e) of the CEA⁶.

With regard to the first point, the IDB member firms of the WMBAA operate some of the most open and efficient financial markets in the world. Under the current U.S. OTC market structure for swaps, IDBs provide multiple competing liquidity pools that enable dealers and institutional customers to freely seek out the best price for a transaction from multiple sources, and we anticipate that this will be further enhanced after IDBs register as SEFs. Furthermore, the vast majority of trading counterparties maintain relationships with many IDBs, and the IDB community has always welcomed the addition of new participants who enhance the ability to obtain pricing and trading interest thereby furthering an open marketplace.

Additionally, the Commission should also consider the fact that members of the WMBAA currently maintain in excess of 5,000 direct, always-open voice lines to wholesale market participants in North America. In addition, the members of the WMBAA operate state of the art real-time electronic brokerage systems and thousands of real-time connections to clients via instant messaging. In the aggregate, these media represent a vast, many-to-many real-time network that is highly competitive, extremely efficient and independent of the clearing function provided by CPC. As noted, this network generates the vast majority of various CPC cleared contracts submitted to CME/NYMEX and is critical to orderly liquidity formation in these vital US markets. Therefore, we would suggest that the Staff carefully consider the utility of Core Principle 9 when applied to trades submitted to CPC by IDB's, especially given the robust and open infrastructure maintained by WMBAA's members.

In addressing the second point, we believe that Core Principle 9 does not mandate that all transactions be executed on a single electronic market or open outcry floor. The contract markets have operated electronic and open outcry markets in tandem, and market participants may choose how and where their orders are executed. In such circumstances, customers may not always receive the best available execution of their orders, but no one has ever suggested that this arrangement is inconsistent with the open and competitive execution requirements of Core Principle 9 and Commission Regulations. Thus, we believe that an arrangement that permits market participants to have their trades executed competitively by an IDB and that operates in cooperation with the DCM is consistent with the mandate of Core Principle 9.

With respect to the third point, we believe that the fact that the market for OTC products is limited to Eligible Contract Participants justifies the use of a different standard from what is typical for a

⁶See, 7 USC §2(e)(2010).



futures market. For liquid products that are traded on a DCM, retail customers compete with institutional market participants for execution of their orders. By contrast, the less liquid products that are brokered by the IDBs and submitted to CPC are longer term, customized, of a significantly large notional value and are entered into by extremely demanding professionals who understand the intricacies of trading in the OTC market. Application of the DCM principles to these professionals and products by disallowing them to privately negotiate the terms of those transactions and obtain the best possible execution for their orders would create a significant disadvantage in the OTC marketplace.

CPC has been and continues to be an extremely valuable service in providing transparency, accountability and stability to the global commodity markets. We understand that CME is exploring a number of proposals that address its conformance with regulation. We are concerned that these proposals may adversely affect the commercial functioning of CPC and the important markets it serves and, thus, do harm to the US economy. We feel that the manner of execution on CPC does comply with the statutory language of Core Principle 9 and protects the OTC market.

We strongly encourage the Commission to consider the valuable service provided by CPC when determining the form of compliance required of it.

Respectfully,

Julian Harding
Chairman, WMBA

Cc: Kathleen M. Kronin, General Counsel
CME Group, Inc.

Thomas LaSala- Managing Director and Global Chief Regulatory Officer
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